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SUBJECT: WHERE KENYA FITS INTO G-8 DEBT RELIEF PROPOSAL

REF: Nairobi 2320

¶1. Summary: News that the new G-8 debt forgiveness plan excludes Kenya as a recipient has been met with public dismay. Complaints about unfairness and concerns about a heavy external debt burden appear misplaced, however. The numbers indicate Kenya's existing stock of external debt is in fact both moderate and sustainable. Moreover, Kenya has cultivated a solid track record, refusing to be grouped among the poorest and most heavily indebted when it restructured its Paris Club obligations over a year ago. Thus, despite its exclusion from the G-8's debt relief initiative, Kenya should benefit from the long-run economic value of being recognized as a reliable borrower. End Summary.

KENYA RESPONDS TO G-8 DEBT RELIEF PLAN: WHY NOT US?

¶2. The realization that the G-8's recently unveiled multilateral debt relief program does not include Kenya among the initial group of nations receiving debt write-offs was met by consternation and anger by some Kenyan officials and media commentators. A front page headline in one local daily declared, "Shock as Kenya Denied Debt Relief". The Chairman of the Parliamentary House Finance Committee, Mutahi Kagwe, was quoted in the press as saying that the plan "appeared to reward countries that have not lived up to their commitment of repaying loans to bi-lateral and multilateral lenders." Kagwe also pointed out that Kenya has always met its debt obligations but has never benefited from relief and likened the principles of HIPC as a "miscarriage of justice," a point reiterated in various media editorials.

¶3. Planning and National Development Minister Peter Anyang' Nyong'o was similarly quoted in the press as saying Kenya's request to the G-8 for inclusion in the list of countries receiving debt write-offs was turned down, which he termed "unfortunate and discriminatory." Still other journalists and would-be experts are touching repeatedly on Kenya's poverty, painting the country's stock of external debt as a staggering, externally imposed burden that is diverting scarce resources away from economic development and poverty reduction. In so doing, they often mix apples and oranges, adding both Kenya's external and domestic debt together to paint a misleading picture of Kenya as being heavily indebted.

A CLOSER LOOK AT KENYA'S NUMBERS

¶4. More sober analysis of the situation, however, indicates these criticisms and concerns are misplaced. Kenya is indeed a poor country - its per capita GDP in 2004 was $481, and 56% of its population lives on a dollar a day or less. But while it was included in the original list of 41 Heavily Indebted Poor Countries (HIPCs) in the late 1990s, Kenya is no longer defined as a HIPC, and for good reason. The reality is that Kenya does not fit the HIPC profile. Compared to Tanzania and Uganda, two neighboring countries included in the initial tranche of countries to receive debt write-offs under the new G-8 initiative, Kenya's stock of external debt burden is not "onerous" and does not pose a significant drain on the Government of Kenya's (GOK) budget. As noted in the Central Bank of Kenya's own assessment, "forecasts for fiscal year 2004/05 indicate less pressure on external debt service following the rescheduling of debt owed to Paris Club creditors." The facts about Kenya's external debt include:

-- Kenya's stock of external debt roughly stands at just over $5 billion;

-- The GOK allocated close to $400 million, or roughly 10% of its total budget for debt servicing on multilateral loans in FY04 compared with 14.0% the previous fiscal year;

-- According to IMF and World Bank statistics, Kenya's debt

service ratio (debt service as a percent of exports) has also been trending downward, decreasing from 14% in FY03 (prior to its Paris Club rescheduling) to 5.0% in FY04. In comparison, Uganda's debt service ratio has actually trended up, increasing from 6.3% in FY02 to 7.1% in FY03. Tanzania's debt service ratio is expected to decline to 11.3% in 2004 from 12.9% in 2003 and 14.6% in 2002;
-- According to the IMF, Kenya's stock of external debt as a proportion of gross domestic output has been trending downward over the last several years reaching 27% in 2004 versus 28% in 2003. This compares to Tanzania and Uganda which toil under (external debt/GDP) ratios of about 83% and 73% respectively;

-- The net present value of Kenya's stock of external debt is roughly 105 percent of exports, well below the HIPC threshold of 150 percent;

-- Kenya's portion of external debt that is multilateral is hovering above 70%, most of which is highly concessional;
--Kenya's ability to sustain its current external debt burden is enhanced by indications of a better performing economy (reftel). In his June 7 budget speech, Finance Minister David Mwiraria noted that Kenya's real GDP growth rate recorded a 4.3% increase in 2004 compared to 2.8% in ¶2003. Mwiraria predicts growth of at least 5% in 2005. [Note: Additional analysis of Kenya's 2005-2006 budget to be provided septel. End Note.]

KENYA: TAKING THE HIGH ROAD ON DEBT RELIEF

¶5. Putting the numbers aside, the GOK itself has in the past taken the high road on debt relief, much to its credit. In fact, Kenya's "Exit Rescheduling" with the Paris Club of official bilateral creditors in January, 2004 was a landmark: A country technically eligible for a 67% write-off under "Naples terms" voluntarily declined to be lumped in with "dead beats" (as the markets would call them), asking only for a restructuring of its obligations. This clear expression of a well-developed "credit culture" was hailed at the time as an indicator of Kenya's economic maturity.

COMMENT

¶6. Kenya should be congratulated, and should be proud of itself, for maintaining its commitments to external creditors, and for paying down its external debt on a timely and consistent basis. The GOK leadership should highlight the fact that Kenya will be rewarded for its efforts, perhaps not through the G-8 proposal, but through a continued positive assessment of the country's economic sovereign risk status in the international financial markets.

¶7. It is ironic that some Kenyan commentators, without correction from informed GOK officials, are fuming that Kenya is not being grouped with the world's poorest countries - countries that are unable to live up to their financial obligations. We are, to date, disappointed that the GOK leadership has not publicly highlighted the long-run value of not being considered among the poorest and most indebted. We hope to see a more mature public debate on the debt issue from the GOK in the coming weeks, including a recognition that Kenya stands to benefit from improved investor confidence in the international capital markets and consequently from improved foreign direct investment.
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